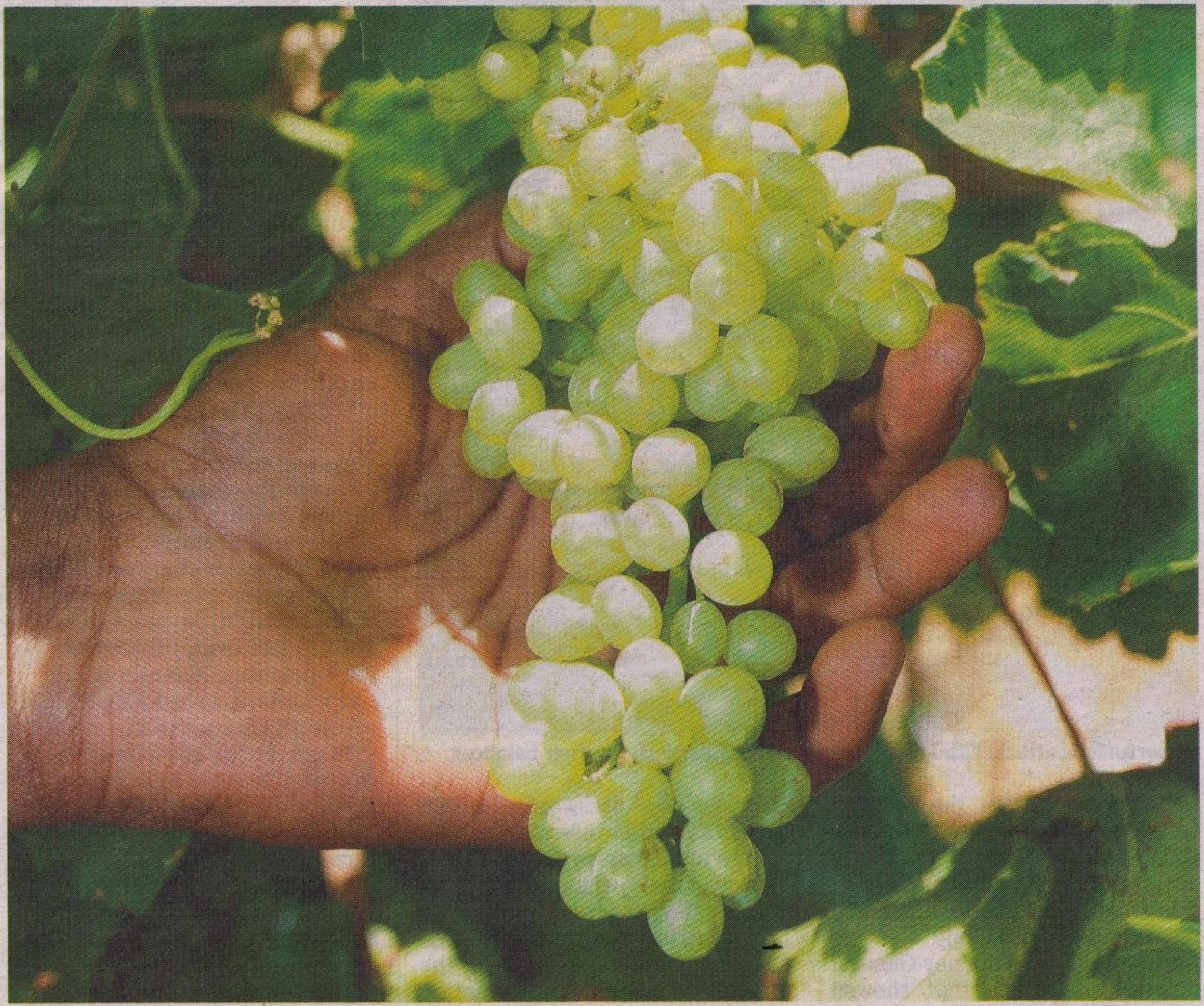
If you lost money, why does your adviser get paid?

David Huggins
Comment



Soured schemes: For many, investing in agribusiness managed investment schemes was a terrible mistake.

For many years, some financial planners advised their clients to invest in agribusiness schemes. These are schemes that were to grow agricultural products such as grapes. For many people they have turned out to be a terrible investment.

The schemes were structured so that the investor paid fees upfront getting an immediate tax deduction and at some time in the future when the scheme started producing, they would receive ongoing income. Importantly, these schemes often required the yearly payment of maintenance and other fees. These substantial fees would be payable for the life of the scheme, which could be more than 15 years.

For a variety of reasons many of these schemes failed. Investors who had borrowed to buy into them were left to pay off big debts and no income to repay them.

Ironically, some of those in schemes that failed were better off than those in schemes that are still going. That's because of the obligation to keep paying maintenance and other fees.

The idea behind the schemes was that once they started producing income, the income would be enough to cover the fees. However, some schemes have not produced any income or are not producing enough to do this.

This has left many people in the position of having to pay fees plus interest on the loan used to buy into the scheme.

That means some people just won't have enough money to live on for the life of the scheme.

Each investor who bought into these schemes faced the risk that while their interest payments and ongoing fees would have to be paid it was practically impossible to predict how much income they would receive and when they would receive it.

That is because of all of the things that can go wrong in farming: bad seasons, falling prices or natural disasters. It is impossible to work out what income a farm is likely to make in a particular year. For example, if a bank makes a billion dollar profit this year it is a reasonable bet that it will make a similar profit next year but the fact that a farm has a good season this year tells you virtually nothing about what the farm might make next year.

This was made worse because predictions were being made about income that would be generated long into the future. Using the bank example, it might be possible to accurately predict what a bank might earn next year but any prediction about what a bank will earn in five or 10 years is unlikely to be very accurate.

Every financial planner who provided advice about these schemes must have understood that the income that a client would actually receive was impossible to predict but that their clients would be in a bad position if the predicted income was not actually paid.

The question, then, is why were so many clients advised to make an investment that had the potentially to do them so much harm?

In many cases, the answer probably lies in the commissions that these schemes paid financial planners. Many schemes paid 10 per cent commission and some also made other payments. These included marketing allowances that meant some financial planning firms received much more than 10 per cent commission.

These payments were far in excess of what financial planners would receive if their clients made other investments and they provided a powerful incentive for financial planners to recommend these schemes to their clients.

Incredibly, some financial planners are entitled to receive a portion of the ongoing fees that must be paid by their clients. That means that many are still being paid for providing advice that has caused their clients to be unable to meet their daily living expenses.

If you have been advised to enter into one of these schemes and have lost money you need to think very carefully about the quality of the advice that you've been given.

David Huggins is a lawyer who specialises in resolving disputes about poor financial advice